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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 1132

GEORGE M. HOLLEY, PETITIONER

v.

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH
CIRCUIT*

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Circuit Court of Appeals (R. 28c-28g) is reported in 124 F. (2d) 909.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on January 10, 1942 (R. 28a). A petition for rehearing was denied February 12, 1942 (R. 28h). The petition for a writ of certiorari was filed April 10, 1942. Jurisdiction of this Court is invoked under section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

I

Whether interest received by petitioner from the City of Detroit on the unpaid balance of a condemnation award resulting from the taking of petitioner's property by the City in eminent domain proceedings, which award was payable in instalments pursuant to a contractual arrangement, should be excluded from gross income under section 22 (b) (4) of the Revenue Acts of 1934 and 1936 as interest on the obligation of a political subdivision of a state.

II

Whether the contention that such interest is taxable as capital gain only, raised for the first time in a petition for rehearing filed in the Circuit Court of Appeals, which dismissed the petition without opinion, is properly raised here and affords a basis for the granting of certiorari.

STATUTE AND REGULATIONS INVOLVED

The Revenue Act of 1934, c. 277, 48 Stat. 680 provides in part:

SEC. 22. GROSS INCOME.

* * * * *

(b) *Exclusions from Gross Income*.—The following items shall not be excluded in gross income and shall be exempt from taxation under this title: * * *

(4) *Tax-Free Interest*.—Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the

District of Columbia; or (B) obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States; or (C) the obligations of the United States or its possessions. Every person owning any of the obligations enumerated in clause (A), (B), or (C) shall, in the return required by this title, submit a statement showing the number and amount of such obligations owned by him and the income received therefrom, in such form and with such information as the Commissioner may require. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit) and in the case of obligations of a corporation organized under Act of Congress, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt from the taxes imposed by this title; * * *

Section 22 (b) (4) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, contains an identical provision.

Treasury Regulations 86, promulgated under the Revenue Act of 1934, provide, in part:

ART. 22 (b) (4)-1. *Interest upon State obligations.*—Interest upon the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia is exempt from the income tax. Obligations

issued by or on behalf of the State or Territory or a duly organized political subdivision acting by constituted authorities empowered to issue such obligations, are the obligations of a State or Territory or a political subdivision thereof. Special tax bills issued for special benefits to property, if such tax bills are legally collectible only from owners of the property benefited, are not the obligations of a State, Territory, or political subdivision. The term "political subdivision," within the meaning of the exemption, denotes any division of the State or Territory which is a municipal corporation, or to which has been delegated the right to exercise part of the sovereign power of the State or Territory. As thus defined, a political subdivision of a State or Territory may, for the purpose of exemption, include special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts and divisions of a State or Territory.

Article 22 (b) (4)-1 of Regulations 94, promulgated under the Revenue Act of 1936, contains an identical provision.

STATEMENT

The City of Detroit in 1927 determined to condemn certain land, including property owned by petitioner, for a street-widening project, provided approximately 75% of the landowners to be af-

fected should sign financing agreements with the City to make possible payment in instalments of the condemnation awards (R. 14). Proceedings in eminent domain were thereupon instituted (R. 18), and after a sufficient number of property-owners had signed financing agreements the City authorized prosecution of the suit to trial (R. 14-15). Petitioner had signed one of the agreements on June 18, 1928 (R. 15). It provided that in the event of condemnation petitioner's award should be payable in ten annual instalments instead of within one year from the time when the award should be confirmed (as provided by the city charter), with interest on the unpaid balance at $4\frac{1}{4}\%$ per annum from the date of confirmation (R. 16); the City might take possession of the land condemned at any time after 90 days from confirmation, and was to receive title contemporaneously with the first payment (R. 17). Article 7 of the agreement provided that it should be construed as a contract between the parties for purchase of the land condemned at the price fixed in the court proceedings (R. 17), but that the City of Detroit could dismiss its suit altogether, in which event the contract would be without effect (R. 18).

The condemnation proceedings were completed on July 21, 1932, and the street-widening operation was begun in 1934 (R. 18). Under the agreement with petitioner the City made interest

payments to him during the tax years as follows (R. 19):

1934-----	\$1,228.15
1935-----	437.72
1936-----	726.98

The petitioner included these amounts in gross income (R. 10-11, 19), paying income tax thereon, and subsequently filed a claim for refund for each taxable year on the ground that the interest payments were exempt from taxation under section 22 (b) (4) of the Revenue Acts of 1934 and 1936 as interest on an obligation of a political subdivision of a state (R. 11-13). The refund claims were denied by the Commissioner of Internal Revenue (R. 13), and petitioner brought suit in the District Court to recover the taxes paid with respect to the receipt of interest on the condemnation award.

The District Court filed findings of fact and announced conclusions of law on May 21, 1940 (R. 10-21). It held that the controverted payments did not fall within the scope of section 22 (b) (4), and on June 13, 1940, entered judgment dismissing the complaint (R. 21). The Circuit Court of Appeals affirmed (R. 28a). A petition for rehearing filed on January 28, 1942, was denied by the Circuit Court of Appeals on February 12, 1942 (R. 28h).

ARGUMENT

1. Previous federal decisions are in accord that an award made in condemnation proceedings is not

an "obligation" of the condemning authority within the purview of section 22 (b) (4) of the Revenue Acts, and accordingly have held that interest paid on such an award is not exempt from income tax. *United States Trust Co. of New York v. Anderson*, 65 F. (2d) 575 (C. C. A. 2), certiorari denied, 290 U. S. 683; *Baltimore & Ohio R. R. v. Commissioner*, 78 F. (2d) 460 (C. C. A. 4); *Robinson v. Commissioner* 80 F. (2d) 1018 (C. C. A. 2), certiorari denied, 298 U. S. 663; *Conyngham v. Commissioner*, 81 F. (2d) 1017 (C. C. A. 3); *Louis Schoen*, 30 B. T. A. 1075; *Mary Lincoln Isham*, 26 B. T. A. 1040; *Leo M. Klein*, 26 B. T. A. 745, appeal dismissed (C. C. A. 2, October 9, 1933); *Kansas City Southern Ry.*, 16 B. T. A. 665, affirmed, 52 F. (2d) 372 (C. C. A. 8) (without discussion of the point here involved), certiorari denied, 284 U. S. 676.

The theory of these cases, embraced by the court below (R. 28e, 28f), that the exemption contained in section 22 (b) (4) must be construed according to the legislative purpose of aiding governmental authorities in the exercise of their borrowing function, received the sanction of this Court in *Helvering v. Stockholms Enskilda Bank*, 293 U. S. 84.¹ There the interest accompanying refund of federal taxes wrongfully collected was held not exempt

¹ See also *American Viscose Corp. v. Commissioner*, 56 F. (2d) 1033 (C. C. A. 3), certiorari denied, 287 U. S. 615 (cited with approval in 293 U. S. at 87).

from income tax under a precursor of section 22
(b) (4). The opinion stated:

* * * It is clear from a consideration of the entire section and of the subject matter that the purpose of Congress, in thus excluding from gross income interest upon * * * obligations [of the United States], was to aid the borrowing power of the federal government by making its interest-bearing bonds more attractive to investors. * * * The scope of the word "obligations" as there employed must be narrowed accordingly, and not extended to include interest upon indebtedness not incurred under the borrowing power, * * *

[293 U. S. 87.]

While the Court in the *Stockholms Enskilda Bank* case was considering the statute with respect to obligations of the United States, it is clear from the framing of the statute that the *rationale* of the decision is of equal application to cases involving obligations of other bodies politic.² Accordingly, petitioner's assertion (Pet. 8) that "the Supreme Court has never held that the exemption of interest upon 'obligations of a State, Territory, or any political subdivision thereof' contained in Sec-

² Cf. 293 U. S. at 87 (citing *United States Trust Co. of New York v. Anderson, supra*); see H. Rep. No. 767, 65th Cong., 2d Sess., p. 9 (1939-1 Cum. Bull. (Part 2), pp. 86, 92); S. Rep. No. 617, 65th Cong., 3d Sess., p. 6 (1939-1 Cum. Bull. (Part 2), pp. 117, 121); H. Rep. No. 1037, 65th Cong., 3d Sess., p. 48 (1939-1 Cum. Bull. (Part 2), pp. 130, 134).

tion 22 (b) (4) should be narrowed to mean only interest upon obligations incurred in the exercise of the borrowing power" is without force.

Petitioner urges in addition (Pet. 6-7) that the interest which it received from the City during the tax years was paid pursuant to an instalment contract the negotiation of which amounted to an exercise of borrowing power by the municipal authority, that it was therefore paid on an obligation of a political subdivision within even the restricted meaning of section 22 (b) (4), and that in this view the decision below presents a conflict with *Commissioner v. Meyer*, 104 F. (2d) 155 (C. C. A. 2); *Kings County Development Co. v. Commissioner*, 93 F. (2d) 33 (C. C. A. 9), certiorari denied, 304 U. S. 559; and *Norfolk National Bank of C. & T. v. Commissioner*, 66 F. (2d) 48 (C. C. A. 4).

Each of those cases concerned a wholly voluntary transaction under which a governmental authority made instalment payments with interest.³ Here, on the other hand, it is clear that the City acquired petitioner's land *in invitum*. The arrangement be-

³ While all three cases held that the respective contractual arrangements gave rise to an "obligation" within the statutory meaning, attention in two was focussed on questions unrelated to this case.

In the *Kings County Development Co.* case the governmental obligor had issued no tangible evidences of indebtedness, but the court held that physical securities were not essential to the existence of "obligations" within the meaning of the statute.

The essential issue in the *Norfolk National Bank* case was whether the obligation was that of a governmental authority or of a private corporation only. See 66 F. (2d) 51, 52.

tween the City and petitioner was entered into in contemplation of the usual proceedings in eminent domain and would be operative only in the event of their completion and the making of a judicial award of compensation; labelling the conditional financing agreement as a contract of sale was ineffective to change its real character in view of the right retained by the City to dismiss the condemnation suit and abandon its project of acquisition entirely. When the condemnation proceedings were completed and the award of compensation to petitioner confirmed, the obligation of the City was on the award, and interest was paid on that obligation; the financing agreement did not affect the character of the obligation, but merely specified a particular mode of discharge.

Plainly, therefore, the situation in the present case is one of interest on a condemnation award, compelling the result that the interest is includible in gross income, under the rule of the cases cited at page 7, *supra*, and accordingly no conflict with the *Meyer*, *Kings County*, and *Norfolk* cases is presented. Rather, the decision below is in complete agreement with decisions of the Court of Claims on identical facts in two tax refund cases. *Williams Land Co. v. United States*, 90 C. Cls. 499; *Posselius v. United States*, 90 C. Cls. 519.

2. Petitioner urges alternatively (Pet. 8-9) that if the interest paid him by the City of Detroit during the tax years was not exempt under section 22 (b) (4) it should be taxed to him only as capital

gain and not as ordinary income; he asserts that the failure of the Circuit Court of Appeals to treat the interest as capital gain conflicts with the decisions of the Second Circuit in *Seaside Improvement Co. v. Commissioner*, 105 F. (2d) 990, certiorari denied, 308 U. S. 618 (petition by taxpayer on other issues), and *Commissioner v. Appleby's Estate*, 123 F. (2d) 700.⁴ However, it cannot be said that the decision below presents any conflict with those cases since the issue on which conflict is alleged was not resolved by the court below. That issue was not raised by petitioner until his petition for rehearing in the Circuit Court of Appeals (see R. 28h *et seq.*)⁵ and there

⁴ Petitioner also cites as conflicting *Henry A. Kieselbach*, 44 B. T. A. 279, and *Edith Henry Barbour*, 44 B. T. A. 1117. The Board's decision in the *Kieselbach* case was reversed by the Circuit Court of Appeals for the Third Circuit on April 7, 1942. See 4 CCH Federal Tax Service [1942], par. 9407.

⁵ Petitioner in the petition for certiorari (Pet. 9) and in the petition for rehearing (page 1) states that the question was presented to the Circuit Court of Appeals in his brief on the merits in that court. An examination of that brief, however, shows that petitioner did not then contend that the interest received on the unpaid balance of the condemnation award was taxable only as capital gain. Instead, petitioner stated in the brief at page 1:

"The only question in this case is whether interest paid to appellant by the City of Detroit on a contract between appellant and the City of Detroit is exempted from income tax by the provisions of Section 22 (b) (4) of the Revenue Act applicable to the years in which the interest was paid."

Paragraph 4 of the petition for rehearing (page 2) argues the factual improbability, if not impossibility, that petitioner

is nothing to show that the court then passed on the question.⁶ It was, of course, discretionary with the court below whether to pass on the issue or not; its failure to do so in the circumstances was clearly not an abuse of discretion. This is true particularly since the taxpayer's claim for administrative refund was based on a specific ground of *exemption* (see R. 11-13) and no attempt was ever made to amend the claim in order to assert the different ground that the interest payments in question, if income, should be treated only as capital gain. It is at least doubtful that such an amendment could have been made in the present case after the original period of limitation for filing a refund claim had expired.⁷ Cf. *United States*

realized any capital gain. The record is devoid of evidence on this point, emphasizing the fact that the issue was raised for the first time in the appellate court.

⁶ The petition for rehearing was denied by the court below without opinion (R. 28h).

⁷ The petition for rehearing was filed on January 28, 1942 (R. 28h). Petitioner filed his most recent return for the tax years here involved on March 15, 1937 (R. 10), and his most recent payment of tax with respect to the interest now in suit was made on June 15, 1938 (R. 11). Section 322 (b) (1) of the Internal Revenue Code provides:

“Unless a claim for credit or refund is filed by the taxpayer within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, no credit or refund shall be allowed or made after the expiration of whichever of such periods expires the later.”

v. *Garbutt Oil Co.*, 302 U. S. 528.⁵ Without proper claim for refund filed with the Commissioner of Internal Revenue, no suit for refund may be maintained. Internal Revenue Code, sec. 3772.

CONCLUSION

The decision of the Circuit Court of Appeals with respect to exemption is correct and presents no conflict. Further, no conflict is presented on the second question since it was not passed on by the court below and has not been properly raised in the present suit. It is therefore respectfully submitted that the petition should be denied.

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MAY 1942.

⁵ Determination of the issue whether the interest received by petitioner from the City of Detroit constituted capital gain rather than ordinary income would have necessitated an inquiry wholly different from that appropriate to determine whether the interest was exempt under section 22 (b) (4) of the Revenue Acts of 1934 and 1936.